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IN THE
Supreme Court of the United States

OCTOBER TERM—1976

No. 76-463

JOEL H. STERNS, Trustee in Bankruptcy
for CALLAHAN MOTORS, INC.,

Petitioner,

vs.

PRINCETON BANK AND TRUST COMPANY,

Respondent.

On Petition for Writ of Certiorari to the United States
Court of Appeals for the Third Circuit

BRIEF OF RESPONDENT IN OPPOSITION

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PRINCETON BANK AND TRUST COMPANY,*Respondent.*

**On Petition for Writ of Certiorari to the United States
Court of Appeals for the Third Circuit**

BRIEF OF RESPONDENT IN OPPOSITION**Statement of the Case**

Respondent Princeton Bank and Trust Company is a creditor of the bankrupt, Callahan Motors, Inc. Prior to the filing of its petition under Chapter XI of the Bank-

ruptcy Act and subsequent bankruptcy, the Bankrupt received financing for its automobile dealership from Respondent. In return Respondent took a security interest in the Bankrupt's new and used motor vehicles and the proceeds from sales thereof. That security interest was perfected by filing a Financing Statement with the Secretary of State of New Jersey on March 5, 1965. Under N.J.S. 12A:9-403(2) that statement remained effective for five years.

On or about July 1, 1967, the New Jersey Department of State sent the following notice to all banks:

**IMPORTANT NOTICE TO ALL SECURED PARTIES OF
FINANCING STATEMENTS FILED UNDER
UNIFORM COMMERCIAL CODE**

12A:9-403.

(2) A filed financing statement which states a maturity date of the obligation secured of 5 years or less is effective until such maturity date and thereafter for a period of 60 days. *Any other filed financing statement is effective for a period of 5 years from the date of filing.* The effectiveness of a filed financing statement lapses on the expiration of such 60 day period after a stated maturity date or on the expiration of such 5 year period, as the case may be, unless a continuation statement is filed prior to the lapse. Upon such lapse the security interest becomes unperfected. A filed financing statement which states that the obligation secured is payable on demand is effective for 5 years from the date of filing.

(3) A continuation statement may be filed by the secured party (i) within 6 months before and

60 days after a stated maturity date of 5 years or less, and (ii) otherwise within 6 months prior to the expiration of the 5 year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number and state that the original statement is still effective. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for 5 years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement.

To remain effective, Continuation Statements must be filed for all Financing Statements filed January 2, 1963 and thereafter. This office will accept Continuation Statements beginning July 1, 1967.

PLEASE FILE EARLY.

On December 29, 1967, Respondent filed, as the secured party, against Cregar Motors, Inc. (the Bankrupt's predecessor) as the debtor, a Continuation Statement. The Court of Appeals found that Respondent's filing of the Continuation Statement may have been triggered by its receipt of the July 1, 1967 notice quoted above (A10). The Secretary of State accepted the filing fee from Respondent and delivered to Respondent the acknowledgement copy showing the filing date of December 29, 1967 and receipt of the filing fee. If valid, this filing would have extended the effectiveness of Respondent's Financ-

ing Statement to March 1975, well after the Chapter XI Petition was filed in this proceeding.

Notwithstanding this filing, however, in March of 1971, the Secretary of State's office destroyed both the original Financing Statement filed in 1965 and the Continuation Statement filed in 1967. The action was based on the Secretary of State's policy that a Continuation Statement filed prior to six months before the Financing Statement's expiration date was premature and would be deemed ineffective. It was the Secretary of State's policy, prior to January 1, 1968, to accept such a prematurely filed Continuation Statement without notifying the filing party that the filing was ineffective. However, on January 1, 1968, the Secretary of State's Office adopted a new policy of returning unfiled to secured parties any document "which the Secretary of State's Office deemed was presented for filing prematurely with a rejection form appropriately checked." Even though Respondent's Continuation Statement was accepted for filing only four days before the institution of this new policy, the Secretary of State never informed Respondent, from the time the Continuation Statement was filed to the time it and the Financing Statement were destroyed, that the Continuation Statement was deemed ineffective. Respondent thus never received notice of the policy or of the documents' destruction.

On February 22, 1973, the debtor Callahan Motors, Inc. filed a Chapter XI Petition, as a result of which a receiver was appointed. On December 30, 1974, Callahan was adjudicated a bankrupt. As of the date of the filing of the Chapter XI Petition and the appointment of the Receiver, the Secretary of State's records showed neither Respondent's Financing Statement nor Continuation Statement against the debtor because of the Secretary of State's destruction of them in 1971.

On March 4, 1973, Respondent filed its petition with the Bankruptcy Court to reclaim the automobiles in the Receiver's possession which it asserted were security for its outstanding loan to the Bankrupt (which exceeded \$200,000). The Bankruptcy Court denied this motion, finding that the Bankrupt's debt to Respondent was unsecured as Respondent had not filed a timely Continuation Statement. On May 14, 1973, Petitioner filed a Petition for Review with the United States District Court for the District of New Jersey. On June 18, 1975, the District Court affirmed the Order of the Bankruptcy Court and denied the Petition (A15-30). On September 12, 1975, Respondent filed its Notice of Appeal from the District Court to the United States Court of Appeals for the Third Circuit.

On July 8, 1976, the Court of Appeals for the Third Circuit reversed the decisions of the Bankruptcy Court and the District Court, found that the Financing and Continuation Statements filed by Respondent had been timely filed and directed the Bankruptcy Court to grant Respondent's Petition for Reclamation to the extent justified by the Financing and Continuation Statements (A12). While the Court of Appeals declined to rule that in every case the acceptance by the Secretary of State of a Continuation Statement filed prior to the final six-period makes it timely filed (A9; A11), the Court of Appeals held that under New Jersey law, N.J.S. 12A:9-403(1), the facts of this particular case, that is Respondent's filing of its Continuation Statement and the Secretary of State's acceptance and later destruction of that filed document without notifying Respondent of the invalidity of the filing or the destruction, constituted a timely and effective filing by Respondent under the appropriate provisions of the Uniform Commercial Code as adopted by the State of New Jersey. In so ruling, the

Court of Appeals relied on its prior decision in *In re Royal Electrototype Corp.*, 485 F.2d 394 (3rd Cir. 1973) where the Court held that, under the Uniform Commercial Code as adopted by Pennsylvania, a creditor had a valid financing statement and was entitled to reclaim property covered by it even though the filing officer had misfiled the financing statement by reversing the names of the secured party and the debtor. In relying on *Royal Electrototype* in this case, the Court of Appeals held:

"We need not, however, go so far as to adopt a general rule that acceptance of a continuation statement by a filing officer cures an untimely presentation. The present record discloses not just a simple acceptance of appellant's statement and fees, but a course of conduct by the Secretary of State which caused the asserted imperfection in filing almost as certainly as did the clerical error in *Royal Electrototype*. On these particular facts, we believe that the same result as in *Royal Electrototype* should follow." (A9)

The Court of Appeals in this case then concluded (A11) that, under New Jersey law, the facts of this particular case made Respondent's filing of its Financing and Continuation Statements timely and effective under the Uniform Commercial Code as adopted in New Jersey and that to hold otherwise would be inconsistent with the equitable character of bankruptcy proceedings.

ARGUMENT

The writ should be denied because the decision of the Court of Appeals makes no change in Bankruptcy Law and involves only the interpretation of state law.

While Petitioner asserts that the Court of Appeals decision was based "solely" on the "equities" (Petition 13), a reading of the Court of Appeals decision discloses that this is not the case. The Court of Appeals only construed the Uniform Commercial Code, as adopted by the State of New Jersey, to determine that Respondent's filing of its Continuation Statement, prior to the final six-month period to the Financing Statement it had previously filed, was timely and therefore extended the expiration date of the original Financing Statement by a five-year period to make it effective as of the date of the filing of the debtor's Chapter XI Petition.

Petitioner's sole basis for seeking the grant of the writ is that the decision of the Court of Appeals allegedly conflicts with §70c of the Bankruptcy Act and the cases interpreting that Section. However, it is elementary under bankruptcy law that any powers are given to the Trustee by §70c are subject to the rights under state law of a creditor holding a perfected lien at the date of the bankruptcy. *In re Allee*, 55 F.2d 76, 77 (7th Cir. 1932); *Porter v. Searle*, 228 F.2d 748, 750 (10th Cir. 1955); *Carroll v. Holliman*, 336 F. 2d 425, 430 (10th Cir. 1964), cert. den. 380 U.S. 903 (1965); *In re Trahan*, 283 F. Supp. 620 (D.C. La. 1968), aff. 402 F.2d 796 (5th Cir. 1968), cert. den. 394 U.S. 930 (1969); 4A *Collier on Bankruptcy* ¶70.49, pages 603-604, ¶70.52[1], ¶70.52A, pages 700-701. In this case, the Court of Appeals ruled that New Jersey law (the Uniform Commercial Code) deems Respondent's filing of its

Continuation Statement to have been timely filed and to have effectively extended the term of the original Financing Statement to make it as valid as if, on the date of the filing of the Chapter XI Petition, a search of the Secretary of State's files against the debtor would have disclosed that Respondent then held a perfected security interest in the debtor's property covered by the Statements. The cases cited by Petitioner (Petition 8-12) all involved situations where the trustee was found to have rights superior to a creditor who did not under State law hold a perfected lien,¹ and therefore these cases only beg the question presented on this Petition. Accordingly, once it was determined by the Court of Appeals that New Jersey law gave Respondent a perfected security interest in the property of the debtor covered by the Financing and Continuation Statements, there was then no question that the trustee's rights were subordinate to that perfected security interest and that

¹ *Sequoia Machinery Co. v. Jarrett*, 410 F.2d 1116 (9th Cir. 1969); Creditor failed to file in all places required by the Code; *United States v. Speers*, 382 U.S. 266 (1965); Creditor (the Internal Revenue Service) failed to file notice of tax lien as required by §6323 of the Internal Revenue Code (26 U.S.C. §6323); *In re P.S. Products Corp.*, 435 F.2d 781 (2nd Cir. 1970); Creditor filed in the wrong county because of Bankrupt's misrepresentations; *In re Dennis Mitchell Industries, Inc.*, 419 F.2d 349 (3rd Cir. 1969); Creditor filed in wrong State because of Bankrupt's breach of contract; *In re Leckie Freeburn Coal Co.*, 405 F.2d 1043 (6th Cir. 1969), cert. den. 395 U.S. 960 (1968); Creditor failed to request that clerk file lease as financing statement; *In re Freeman*, 294 F.2d 126 (3rd Cir. 1961); Creditor filed for factor's lien when he was not a factor under New Jersey statute; *In re Parkway Knitting Mills, Inc.*, 119 F.2d 605 (2nd Cir. 1941), cert. den. 314 U.S. 646 (1941); Creditor, upon refiling a chattel mortgage, failed to indicate time and place where original filing had been made as specified in New York chattel mortgage statute.

§70c does not give the trustee any rights which would make him superior to that perfected lien.

That the decision by the Court of Appeals involved only the interpretation of New Jersey law, that is the provisions of the Uniform Commercial Code as adopted by New Jersey, is clear from a reading of the Court of Appeals opinion. The Court's decision was based on its earlier opinion in *In re Royal Electrototype Corp.*, 485 F.2d 394 (3rd Cir. 1973) (A9). In *Royal Electrototype*, the Pennsylvania Secretary of the Commonwealth accepted a Financing Statement for filing which was then misindexed in its files, indexing the debtor as the creditor and the creditor as the debtor. As a result, a search of the Secretary's records against the actual debtor would not have disclosed the filed statement. The erroneous indexing of the parties was listed on the receipt given the filing party at the time of filing, but the filing party did not acquire knowledge of the mistake until after the debtor had been adjudicated a bankrupt. The Court of Appeals reversed the District Court and directed the Bankruptcy Court to grant the filing party's Petition for Reclamation as it found the security interest to have been perfected and therefore effective against the debtor's Trustee in Bankruptcy. The Court based its opinion on Pennsylvania law, Section 9-403(1) of the Uniform Commercial Code, which provides that "filing" under the Code consists solely of the presentation for filing of the Financing Statement and the tender of the filing fee or the acceptance of the Statement by the filing officer. The Court found the purpose of Section 9-403(1) to be described in the official Code comment:

"* * * Note, however, that under Section 9-403(1), the secured party does not bear the risk that the filing officer will not properly perform his duties. Under that Section, the secured party has complied

with the filing requirements when he presents his financing statement for filing and the filing fee has been tendered or the statement accepted by the filing officer." (485 F.2d at p. 396) [emphasis supplied]

[The same official comment accompanies N.J.S. 12A:9-407.]

Based on this official comment to Section 9-403(1), the Court held that under Pennsylvania law, notwithstanding the fact that the filing party could have learned of the Secretary's indexing error by examining the receipt, the filing of the Financing Statement gave the filing party a perfected security interest superior to that of the Trustee in Bankruptcy. As a result, the creditor was held to be superior to the Trustee even though a search of the filing records on the date the Bankruptcy Petition was filed would not have disclosed any security interest of the creditor against the bankrupt.

In applying *Royal Electrototype* to this case, the Court of Appeals held:

"* * * On these particular facts, we believe that the same result as in *Royal Electrototype* should follow." (A9)

The Court then described the "particular facts" as the July 1967 letter from the Secretary of State to all filing parties which was ambiguous enough to have caused Respondent to interpret the notice as requiring the early filing of the Continuation Statement, the failure of the Secretary of State to notify Respondent when it presented the Continuation Statement for filing in December of 1967 that such a filing was premature and therefore invalid, and the Secretary of State's failure in 1971 to

notify the Respondent that it was destroying both the Financing and Continuation Statements, leaving Respondent unperfected and not in a position to know that it should refile to perfect its security (A9-11). The Court of Appeals concluded that, while New Jersey law might not make every Continuation Statement timely filed if accepted by the filing officer prior to the final six month period, New Jersey law would, upon the facts summarized above, hold that the acceptance and filing by the Secretary of State of Respondent's Continuation Statement in 1967 made that filing a timely filing and therefore made the Respondent a perfected creditor with rights superior to those of the receiver/trustee notwithstanding the fact that a search of the Secretary of State's records on the date of the filing of the Chapter XI Petition did not disclose the existence of a perfected security interest on behalf of the Respondent against the debtor (A11). There is thus no doubt that the Court of Appeals in this case applied New Jersey law to determine that Respondent's Financing and Continuation Statements were effective and timely filed and that Respondent therefore had a perfected security interest as of the date of the filing of the Chapter XI Petition. This finding necessarily means that the Respondent's security interest is superior to the rights of the receiver/trustee under §70c of the Bankruptcy Act.

Neither the Court of Appeals decision in this case nor *Royal Electrototype* conflicts with either New Jersey law or any decisions rendered by other Courts of Appeals. Since there is no New Jersey decision on point, New Jersey Courts might well consider the decision in this case and *Royal Electrototype* as authority in New Jersey.² In

² New Jersey courts have held that due to the legislature's policy in enacting the Uniform Commercial Code of encouraging uniform interpretation on a nation-wide basis, sister state interpretations are more than mere persuasive authority. *R.J. Armstrong, Inc. v. Janburt Embroidery Corp.*, 97 N.J. Super. 246, 259 (L. Div. 1967).

addition, *Royal Electrotpe* has been cited with approval for this holding by at least two federal District Courts. In *In re Lee May Industries, Inc.*, 380 F. Supp. 1, 3 (S.D. N.Y. 1974), *aff'd* 501 F.2d 1407 (2nd Cir. 1974), that Court followed the Third Circuit decision in holding a security interest perfected where the Financing Statement had apparently been lost by the Secretary of State's Office after its presentation by the creditor. In *In re Fowler*, 407 F. Supp. 799, 803-4 (D. Okla. 1975), the *Royal Electrotpe* decision was used as authority for holding that the filing of a Financing Statement which included the names of three debtors but was only indexed under one of the names perfected a security interest against all three.

While holding that Respondent, at the time of the filing of the Chapter XI Petition, was under New Jersey law a creditor with a perfected security interest and therefore superior to the rights of the receiver/trustee, the Court of Appeals ruled that to hold otherwise "... would be inconsistent with the equitable character of bankruptcy proceedings." (A11). Petitioner has seized on this one aspect of the opinion to argue that this was in fact the "sole basis" of the opinion, notwithstanding the extensive discussion and application by the Court of Appeals of New Jersey law discussed above. What this ruling means is only that the construction of the Uniform Commercial Code as adopted by New Jersey, when applied to the facts of this case, is not inconsistent with the equitable nature of bankruptcy proceedings and therefore not in conflict with Federal Bankruptcy Law. In fact, the Court of Appeals went further and ruled that, if the Uniform Commercial Code, as adopted in New Jersey, were to be construed to bar Respondent's Petition for Reclamation, such a construction would be inconsistent with the equitable nature of bankruptcy proceedings. Thus, while

the Court of Appeals pointed out that its ruling, which gave the Respondent the position of a creditor with a perfected security interest superior to the interest of the receiver/trustee, was not inconsistent with Federal law governing bankruptcy proceedings, it must be remembered that the ruling was based on the construction and application of New Jersey law.

CONCLUSION

The decision of the Court of Appeals for the Third Circuit involves solely the question of whether New Jersey law, more precisely the relevant provisions of the Uniform Commercial Code as adopted by the State of New Jersey, accorded Respondent, as of the date of the filing of the Chapter XI Petition, the status of a creditor with a perfected security interest. Once the Court of Appeals determined Respondent held that status, it necessarily followed as a matter of bankruptcy law that Respondent as such a creditor was superior to the interests of the receiver/trustee in the assets covered by Respondent's security agreement. Accordingly, the decision by the Court of Appeals does not involve any substantial questions under the Bankruptcy Act, including §70c of the Bankruptcy Act, because once the Court of Appeals determined that New Jersey law made Respondent a creditor with a perfected security interest as of the date of the filing of the Chapter XI Petition, §70c then had no relevance to the question of the Trustee's rights since he was unquestionably subordinate to Respondent as a perfected secured creditor.

In addition, the decision of the Court of Appeals that New Jersey law, the provisions of the Uniform Commercial Code adopted by New Jersey, made Respondent

a creditor with a perfected security interest as of the date of the filing of the Chapter XI Petition does not conflict with any decision of the Courts of the State of New Jersey since there are no such decisions on this point. In fact, the New Jersey courts would in all likelihood follow the rulings of the Court of Appeals in both in this case and the *Royal Electrototype* case. In addition, the decision of the Court of Appeals here is not only not in conflict with any decision of any other Court of Appeals with respect to this interpretation of the Uniform Commercial Code but is consistent with the earlier decision of the Court of Appeals for the Third Circuit in the *Royal Electrototype* case which itself has been followed by two District Court opinions, one of which was affirmed in 1974 by the Court of Appeals for the Second Circuit.

Accordingly, for the reasons set forth above, the Petition for the Writ of Certiorari should be denied.

Respectfully submitted,

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